
We just had to act. The market forced us.

— Wholesale Distribution CEO

This book is about the unprecedented challenges facing wholesale distribution companies and what they can do to meet them. Since the beginning of 2008, more and more wholesale distribution executives have recognized an urgent need to take positive action. But the driving factors are not entirely new. The industry has often struggled to understand and adapt to macroeconomic forces such as globalization, accelerating product life cycles, and multiplying sales channels.

As a group, wholesaler-distributors are generally (and often proudly) sales-driven companies. They are highly responsive to customers and organized around their sales force. Most wholesaler-distributors were founded by entrepreneurial salesmen, so the connection to the customer is deeply wired into the culture. Although being sales and customer driven is certainly better than having a purely internal focus, it is no longer enough. A well-run, sales-driven company can react quickly to changing market conditions (by cutting expenses in a downturn, for example). But it will probably never get ahead of

the market if it relies on the sales force as its primary window to the world. Sales reps are simply too emotionally and financially tied to the status quo to lead a change.

Exhibit I-1 defines three stages in businesses’ strategic evolution. Operations-driven firms focus inward, on their own products and services. They are like a horse with blinders on, trotting in a straight line without being too distracted by the market environment. Sales-driven companies, on the other hand, have taken off the blinders. Their outward focus helps them respond quickly to customers, but makes them more likely to meander off in different directions. A market-driven paradigm combines the best of both worlds—the ability to follow through on a set course of action based on a full view of the market.

Our research shows that successful wholesaler-distributors have moved beyond a sales-driven paradigm to become market driven and strategically led. Unfortunately, our research also shows that the transition is painful and risky.

The evolution to a market-driven approach has been led by lines of trade in which competitive pressures have been extreme for a long time, such as electronics and industrial supplies. Wholesaler-distributors in these lines of trade expanded from traditional product sales into higher value services, such as integrated supply. These shifts often occurred before customers began asking for anything different and in

Exhibit I-1. Strategic evolution of a business.

Operations Driven	Sales Driven	Market Driven
<ul style="list-style-type: none"> • Internal focus on efficiency and expense control • Priority driven • Analytically led 	<ul style="list-style-type: none"> • External focus on satisfying customers • Responsive and reactive • Opportunistic 	<ul style="list-style-type: none"> • Balanced internal/external perspective • Proactive and responsive • Analytically led • Strategically driven

spite of resistance from the sales force. By addressing their customers' fundamental business drivers rather than just reacting to what their sales reps were hearing, these wholesaler-distributors demonstrated the progression from a sales-driven to a market-driven model.

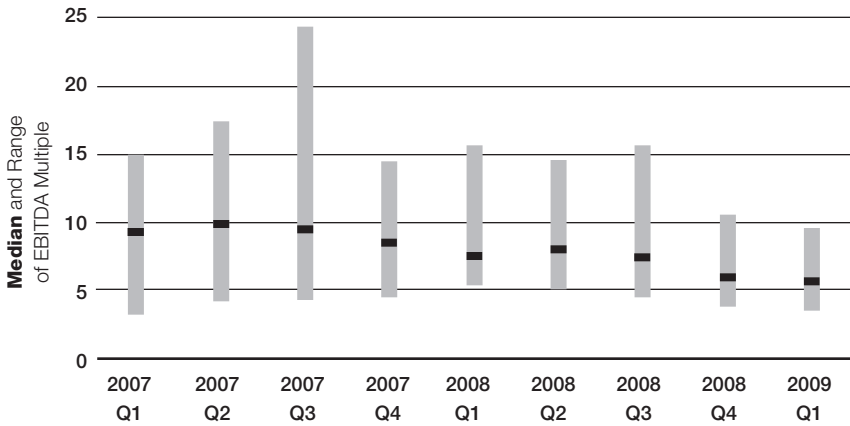
Private-equity buyers also have propelled the transition by introducing more disciplined and sophisticated management practices to the distribution industry. The need to justify acquisition prices to their investors forces them to clearly define value creation strategies that can offer step changes in profitability, not just incremental improvements. Their search for value has led them to question long-held assumptions and rethink business models. They have driven innovation in areas such as strategic pricing, customer segmentation and positioning, management control systems, and sales organization.

Our research indicates that adopting a market-driven, value creation strategy can yield significant and rapid financial benefits. These returns derive from both competitive advantage (that is, the ability to extract a premium from the market) and, perhaps less obviously, improved execution and productivity. Strategic clarity improves communication, empowers the organization, and helps to highlight organizational misfits. In the words of a *Fortune* 500 executive vice president, "It takes away all the hiding places."

The investment community perceives large differences in wholesaler-distributors' value creation potential, even within the same line of trade. Exhibit I-2 illustrates the wide range of earnings multiples assigned to publicly traded industrial wholesaler-distributors.

Executives may obsess about average multiples, but exhibit I-2 shows that the valuation range within an industry can be more significant. For instance, in the third quarter of 2008 the median multiple was 7.4, but the range between highest (15.7) and lowest (4.4) was 11.3.

This book is about getting to the top of the valuation range by executing a market-driven strategy.

Exhibit I-2. Range of enterprise values as a multiple of EBITDA.*

*Total market capitalization divided by pro forma earnings before interest, taxes, depreciation, and amortization (EBITDA) for 27 publicly traded industrial wholesaler-distributors. Median 2008 EBITDA for this group was approximately \$140 million.

Source: Modern Distribution Management newsletter and Robert W. Baird & Co. Inc., based on public information.

Background and Methodology

This book began as a research project about market forces in the distribution industry conducted by our firm, Indian River Consulting Group (IRCG). The project was sponsored by the NAW Institute for Distribution Excellence. The process has yielded some powerful insights and some surprises.

We started by conducting two surveys on supply chain issues, one for wholesale distribution executives (from which we received 197 responses) and one for manufacturers (56 responses). Survey responses were used to frame our questions for the next phases of our research. These questions included

- ◆ How have you responded to key market forces?
- ◆ Which of these responses worked and which did not? Why?
- ◆ What is your firm's strategy for increasing enterprise value and how has it evolved over time?

- ◆ What barriers have kept you from executing your strategy and how have you overcome them?
- ◆ What are the economies and diseconomies of scale in your business?

Next, we conducted in-depth interviews with more than 30 wholesale distribution senior executives as well as private equity firms with considerable wholesale distribution holdings. These interviews covered the executives' experiences with their own companies as well as their views on industry trends and the competitive environment. We augmented these data with our hands-on consulting experience. IRCG has provided business advisory consulting for hundreds of clients, including wholesaler-distributors, private equity firms, investment bankers, suppliers that sell through distribution, and distribution customers (contractors, retailers, and manufacturers, for example). We reviewed more than 40 of our strategy development and execution projects to identify common themes.

The interplay between interview findings and our consulting work proved to be especially powerful. For example, we discovered a clear relationship between corporate governance and strategic performance. Our analysis focused on finding these types of common patterns by asking the following questions:

- ◆ What are the conditions under which different strategies work best?
- ◆ Why do value creation strategies succeed or fail?
- ◆ What are the most common internal limitations and roadblocks?
- ◆ How can a wholesaler-distributor best ensure proper execution of its strategy?

We believe stories can be more powerful than theories. This book is rich in authentic examples from a variety of sources. To protect confidentiality, in many instances we have disguised the line of trade and/or geography of the companies involved.

The final pieces of the puzzle were filled in by secondary research from several sources. We were fortunate to have access to summary data from the Profit Planning Group, the premier provider of distribution industry benchmarking services. These data consisted of aggregate revenue, gross profit, expense, and balance sheet figures grouped by company size and line of trade. The Profit Planning Group adheres to a strict confidentiality protocol and protects the identity of specific companies and trade associations. However, summary-level data allowed us to evaluate relationships between various financial metrics and company size, both in absolute terms and in relative terms within a line of trade.

We are also indebted to Industrial Market Information, which provided us with trends in distributor firm counts over time. IRCG's internal best practices database and publicly available market studies were additional sources for secondary research.

Audience

We wrote this book primarily for wholesale distribution top executives, directors, and those who aspire to those positions. We believe that many of the subjects also will appeal to wholesale distribution investors (including private equity firm partners, investment bankers, and pension fund managers) and channel partners (manufacturers' sales and marketing executives).

One of the challenges for any strategy book is the trade-off between breadth and depth. Going narrow and deep would be difficult in the wholesale distribution industry because it covers such a broad spectrum: lines of trade ranging from steel service centers to flower brokers. Many wholesaler-distributors identify themselves more closely with the products they sell ("we are in the electrical business") than with the distribution label. How could we talk meaningfully about a market-driven strategy when the markets are all so different?

On the other hand, a broad but shallow study would run the risk of generalizing away the very nuances that distinguish high performers from the rest. The world does not need another generic business book on synergies, core competencies, or leadership. (If you have ever worked with Indian River Consulting Group you know that we have a strong preference for practice over theory.)

The answer to this conundrum is patterns. Our research shows that successful value creation often shares a common set of attributes that span different market conditions and organizational capabilities. Although there are no silver bullets, there are highly actionable insights. You can rest assured that you will get more than vacuous theory and platitudes from this book. If nothing else, it provides a great checklist of what *not* to do.

Organization

Many common value creation patterns are the result of fundamental characteristics shared by all wholesaler-distributors. These traits are described in Chapter 1: Distribution Is Different. If you have ever scratched your head wondering why the universal strategy play-book seems to work everywhere except wholesale distribution, this chapter is for you. It creates the foundation for the key points made in the remainder of the book. This chapter will help executives and investors determine whether the daily chaos so characteristic of wholesaler-distributors reflects healthy “micro marketing” or management dysfunction.

Chapter 2: The Model Matters describes how successful distributors define their goals based on external market gaps, not internal weaknesses. It shows the importance of direct connections between clear value propositions and daily activity. If you are directly involved in developing and executing strategy, this chapter is essential reading.

Chapter 3: *The Emperor Is Far Away* is about execution. High-performance companies do not separate strategy development from implementation—they design execution into the process from the beginning. This often means leveraging and embracing a decentralized sales and branch structure, not fighting it. Read this chapter carefully if you have ever struggled with motivating a complacent sales force or finding enough Supermen™ to run your branches.

Chapter 4: *Scalpel Strategy* covers common performance barriers. Wholesaler-distributors often invest significant resources in strategic initiatives and process improvement without realizing an appropriate return. Our research shows that the root cause is often located in the executive suite or with the board of directors. This may make uncomfortable reading, but it is an essential chapter for top managers, directors, and investors.

One of the most pervasive wholesale distribution value creation strategies is simple expansion, whether by consolidation (through mergers and acquisitions) or start-up. This quest for economies of scale is the subject of Chapter 5: *Go Big or Go Home?* We review the data to identify the real opportunities and common pitfalls of this strategy. There is, in fact, a formula for success, but it differs from the common wisdom. This chapter is a cautionary tale for those with aggressive growth ambitions.

Chapter 6: *Closing the Strategy Gaps* weaves together the common threads from the rest of the book. It identifies the underlying factors that separate the shining successes from the shooting stars. This chapter provides a set of questions to help you evaluate the fitness of your own organization's strategy.